

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Joseph T. Kelliher, Chairman;
Sudeen G. Kelly, Marc Spitzer,
and Philip D. Moeller.

New Covert Generating Company, LLC

Docket No. ER06-1058-000

ORDER ACCEPTING AND SUSPENDING PROPOSED TARIFF AND
ESTABLISHING HEARING AND SETTLEMENT JUDGE PROCEDURES

(Issued July 28, 2006)

1. New Covert Generating Company, LLC (New Covert) filed a proposed tariff on May 31, 2006, specifying its cost-based revenue requirement for providing Reactive Supply and Voltage Control from Generation Sources Service (Reactive Supply Service). In this order, we will accept the proposed tariff for filing, suspend it for a nominal period, to become effective on the first day of the month following the date of this order, subject to refund. We also will establish hearing and settlement judge procedures.

Background

2. New Covert is a non-utility generator that owns a 1,079 megawatt generating facility in Covert Township, Wayne County, Michigan.¹ The generating facility is interconnected with Michigan Electric Transmission Company's (METC's) transmission facilities, which Midwest Independent Transmission System Operator, Inc. (Midwest ISO) operates. The New Covert generating facility began commercial operation in January 2004.

¹ New Covert is a limited liability company whose ownership interests are held by MACH Gen, LLC, and is an exempt wholesale generator as defined in section 32 of the Public Utility Holding Company Act of 1935. *See New Covert Generating Co., LLC*, 103 FERC ¶ 62,144 (2003). New Covert is authorized to sell capacity, energy, and certain ancillary services at market-based rates. *See New Athens Generating Co. LLC, et al.*, Docket No. ER03-720-000 (June 6, 2003) (unpublished letter order).

New Covert's Filing

3. New Covert states that it is filing its Reactive Supply Service revenue requirement pursuant to Schedule 2 of the Midwest ISO Transmission Energy Markets Tariff (TEMT). New Covert describes Schedule 2 as allowing Midwest ISO to compensate generators providing Reactive Supply Service based on their Commission-approved revenue requirement. Additionally, New Covert states that section 6.6.2 of the Generator Interconnection and Operating Agreement between New Covert and METC provides that New Covert shall be compensated for Reactive Supply Service in accordance with its filed tariff for such service and/or in accordance with any Midwest ISO TEMT requirements.

4. New Covert proposes an annual Reactive Supply Service revenue requirement of \$3,266,258. The proposed revenue requirement consists of two components: (1) a fixed capability component, which represents the portion of the plant investment in the generating facility that can be attributed to the production of reactive power; and (2) a heating loss component that is designed to recover the cost of increased generator heating losses that result from the production of reactive power. In addition, as a non-utility generator not subject to traditional rate regulation, New Covert has incorporated a proxy rate of return on equity, overall rate of return, and capital structure. New Covert proposes to use a rate of return on equity of 12.88 percent, based on the return approved by the Commission for use by Midwest ISO transmission owners, and an overall rate of return and capital structure based on METC, the transmission owner to which its generator is interconnected. New Covert states that its approach for determining the plant cost to be reflected in a revenue requirement for Reactive Supply Service is consistent with Commission precedent.²

5. New Covert asks the Commission to waive its 60-day prior notice requirement so that the proposed tariff may become effective on June 1, 2006, one day after it submitted its tariff for filing with the Commission.

Notices of Filing and Responsive Pleadings

6. Notice of New Covert's filing was published in the *Federal Register*, 71 Fed. Reg. 34,910 (2006), with comments, interventions, and protests due on or before June 21, 2006. METC and Midwest ISO filed timely motions to intervene. Consumers Energy Company (Consumers Energy) filed a timely motion to intervene and comments. Michigan Public Power Agency (Michigan PPA) filed a timely motion to intervene and protest. On July 6, 2006, New Covert filed a motion for leave to answer and answer to the protests of Consumers Energy and Michigan PPA.

² Citing *American Electric Power Service Corp.*, 88 FERC ¶ 61,141 (1999).

7. Michigan PPA opposes New Covert's proposed revenue requirement for several reasons. First, Michigan PPA argues that New Covert should not use METC's return on equity, capital structure, and overall rate of return as a proxy in calculating the New Covert annual revenue requirement for Reactive Supply Service. Michigan PPA states that METC and New Covert cannot be compared and that applying the return on equity for a transmission-only entity (METC) to an entity engaged solely in generation (New Covert) simply because there is an interconnection point between the two entities is not rational. Michigan PPA claims that New Covert's proposed return on equity of 12.88 percent is inappropriate for a generation-only entity because it includes a fifty basis point adder that the Commission has held only applies to transmission facilities, and not generation facilities used to provide ancillary services,³ and, furthermore, that the Commission did not approve a generic return on equity for transmission owners to use in formulating ancillary service rates.

8. Second, Michigan PPA claims that New Covert's use of a power factor of 0.85 overstates the allocation of generation assets to Reactive Power Service. Michigan PPA asserts that New Covert should base its power factor calculation on the required power factor at the METC interconnection point, which is 0.892. Third, Michigan PPA contends that New Covert overstated its heating losses calculations by assuming that its generating units were operating at rated capability and not taking into account the actual output for each generating unit. Fourth, Michigan PPA states that the inclusion of heating losses for Reactive Supply Service is inappropriate and that Schedule 2 of Midwest ISO's TEMT does not provide for recovery of such heating losses. Finally, Michigan PPA suggests that New Covert should more specifically describe its generating facility in the tariff in order to tie the revenue requirement to the specific facility.

9. Consumers Energy states that there are basic problems with the way New Covert proposes to calculate and support its proposed revenue requirement. First, Consumers Energy contends that New Covert should use a power factor of 0.892 as set forth in METC's annual Commission Form 715 filing, instead of 0.85. Second, Consumers Energy explains that New Covert is a generator providing reactive power (an ancillary service) and the Commission rejected the use of a 12.88 percent return on equity for the provision of ancillary services.⁴ Additionally, Consumers Energy asserts that New Covert does not offer support in the form of financial or risk testimony for its use of METC's capital structure and return components. Third, Consumers Energy argues that New Covert's proposed use of a 50/50 capital structure based on the capital structure approved for a Midwest ISO transmission owner, METC, is inappropriate because New Covert is providing a generation service and not a transmission service. Fourth,

³ Citing *Detroit Edison Company*, 105 FERC ¶ 61,264 (2003).

⁴ *Id.*

Consumers Energy claims that New Covert does not provide support for its proposed cost of debt level. Fifth, Consumers Energy avers that New Covert overstated its generating plant investment figures by not giving a salvage value figure for its plant and by not factoring into its plant figures any depreciation costs for the years its plant has already been operated, which in effect is an attempt retroactively to recover its depreciation expense.

10. In addition to noting problems with the calculation of the proposed revenue requirement, Consumers Energy raises other problems. Consumers Energy asserts that New Covert should adjust the data on the original cost of the plant to closely reflect New Covert's actual costs because New Covert obtained ownership of the plant as a result of proceedings in bankruptcy. Consumers Energy states that what New Covert paid for these assets may be significantly different from what they originally cost. Consumers Energy also alleges that New Covert's filing presents no verification as to the accuracy of the cost data offered by New Covert's only witness, who is a consultant rather than a New Covert employee. Consumers Energy additionally asserts that New Covert did not meet all the prerequisites for receiving Schedule 2 payments from Midwest ISO. Finally, Consumers Energy argues that the requested effective date does not comply with Midwest ISO's Schedule 2 and should not be granted. Consumers Energy states that Schedule 2 specifically provides that recovery of the reactive power revenue requirement shall not start until the first day of the month after the Commission has accepted a revenue requirement.

Discussion

Procedural Matters

11. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214 (2005), the timely, unopposed motions to intervene serve to make the entities that filed them parties to the proceeding. Rule 213(a)(2) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213(a)(2)(2005), prohibits an answer to a protest unless otherwise ordered by the decisional authority. We are not persuaded to accept New Covert's answer and will, therefore, reject it.

Hearing and Settlement Judge Procedures

12. New Covert's proposed tariff raises issues of material fact that cannot be resolved based on the record before us, and are more appropriately addressed in the hearing and settlement judge procedures ordered below.

13. Our preliminary analysis indicates that New Covert's proposed tariff has not been shown to be just and reasonable and may be unjust, unreasonable, unduly discriminatory or preferential, or otherwise unlawful. Therefore, we will accept New Covert's proposed

tariff for filing, suspend it for a nominal period, make it effective on the first day of the month following the date of this order, and set it for hearing and settlement judge procedures.

14. While we are setting these matters for a trial-type evidentiary hearing, we encourage the parties to make every effort to settle their dispute before hearing procedures are commenced. To aid the parties in their settlement efforts, we will hold the hearing in abeyance and direct that a settlement judge be appointed, pursuant to Rule 603 of the Commission's Rules of Practice and Procedure.⁵ If the parties desire, they may, by mutual agreement, request a specific judge as the settlement judge in the proceeding; otherwise, the Chief Judge will select a judge for this purpose.⁶ The settlement judge shall report to the Chief Judge and the Commission within 60 days of the date of the appointment of the settlement judge concerning the status of settlement decisions. Based on this report, the Chief Judge shall provide the parties with additional time to continue their settlement discussions or provide for commencement of a hearing by assigning the case to a presiding judge.

Effective Date

15. We will deny New Covert's request for waiver of the Commission's prior notice requirement to permit an effective date of June 1, 2006. As Consumers Energy points out, Schedule 2 of the Midwest ISO's TEMT provides that, unless Midwest ISO issues a deficiency notice, "Qualified Generator status is effective on the first day of the month immediately following acceptance of the revenue requirement by the Commission or the first day of the month if Commission acceptance of such revenue requirement is on the first day of the month."⁷ Accordingly, the effective date for the proposed tariff must be the first day of the month following the date of this order.

⁵ 18 C.F.R. § 385.603 (2005).

⁶ If the parties decide to request a specific judge, they must make their joint request to the Chief Judge by telephone at (202) 502-8500 within five days of this order. The Commission's website contains a list of Commission judges and a summary of their background and experience (www.ferc.gov – click on Office of Administrative Law Judges).

⁷ Midwest ISO TEMT, Schedule No. 857B, section II.C. of Schedule 2

The Commission orders:

(A) New Covert's proposed tariff for Reactive Supply Service is hereby accepted for filing and suspended for a nominal period, to become effective on the first day of the month following the date of this order, subject to refund, as discussed in the body of this order.

(B) Pursuant to the authority contained in and subject to the jurisdiction conferred upon the Federal Energy Regulatory Commission by section 402(a) of the Department of Energy Organization Act and by the Federal Power Act (FPA), particularly sections 205 and 206 thereof, and pursuant to the Commission's Rules of Practice and Procedure and the regulations under the FPA (18 C.F.R., Chapter I), a public hearing shall be held concerning New Covert's proposed tariff. However, the hearing shall be held in abeyance to provide time for settlement judge procedures, as discussed in Paragraphs (C) and (D) below.

(C) Pursuant to Rule 603 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.603 (2005), the Chief Administrative Law Judge is hereby directed to appoint a settlement judge in this proceeding within fifteen (15) days of the date of this order. Such settlement judge shall have all powers and duties enumerated in Rule 603 and shall convene a settlement conference as soon as practicable after the Chief Judge designates the settlement judge. If the parties decide to request a specific judge, they must make their request to the Chief Judge within five (5) days of the date of this order.

(D) Within sixty (60) days of the date of the appointment of the settlement judge, the settlement judge shall file a report with the Commission and the Chief Judge on the status of the settlement discussions. Based on this report, the Chief Judge shall provide the parties with additional time to continue their settlement discussions, if appropriate, or assign this case to a presiding judge for a trial-type evidentiary hearing, if appropriate. If settlement discussions continue, the settlement judge shall file a report at least every sixty (60) days thereafter, informing the Commission and the Chief Judge of the parties' progress toward settlement.

(E) If settlement judge procedures fail and a trial-type evidentiary hearing is to be held, a presiding judge, to be designated by the Chief Judge, shall, within fifteen (15) days of the date of the presiding judge's designation, convene a prehearing conference in these proceedings in a hearing room of the Commission, 888 First Street, NE, Washington, DC 20426. Such a conference shall be held for the purpose of establishing a procedural schedule. The presiding judge is authorized to establish procedural dates and

to rule on all motions (except motions to dismiss) as provided in the Commission's Rules of Practice and Procedure.

By the Commission.

(S E A L)

Magalie R. Salas,
Secretary.